ESTIMATING THE OPTIMAL THRESHOLD VALUE FOR FOREIGN INVESTMENT IN MALAYSIA

RESEARCH MANAGEMENT INSTITUTE (RMI)
UNIVERSITI TEKNOLOGI MARA
40450 SHAH ALAM, SELANGOR
MALAYSIA

BY :

NOOR ZAHIRAH MOHD SIDEK
MAHADZIR ISMAIL

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1. Letter of Report Submission

BORANG TAMAT PROJEK GERAN PENYELIDIKAN

BAHAGIAN A : MAKLUMAT KETUA PROJEK	
Nama	NOOR ZAHIRAH MOHD SIDEK
Alamat Pusat Tanggung Jawab (PTJ)	UiTM KEDAH PETI SURAT 187 MERBOK 08400 SUNGAI PETANI KEDAH
Tajuk Projek:	THE IMPACT OF PRIVATE INVESTMENT ON INCOME PER CAPITA
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Pelajar yang di latih (Nama, KP, Kod Program)	1. MUNIRAH AHMAD SANI 890108-08-5892 / BM229 2. SITI AISYAH HANIMI AZMI 891103-08-5150 / BM229 3. NUR HAFISYA MAD ALI 870617-02-5312 / BM229
Tandatangan Ketua Projek	: Noor Zahirah Tarikh : 2 OKTOBER 2012
Pengesahan RMI	: Tarikh :

5. Report

5.1 Proposed Executive Summary

(Original proposal – 300 words) – 1 page only

The major thrusts of the 10th Malaysia Plan are geared towards transforming Malaysia into a high income nation. Higher income per capita can only be achieved with higher growth of GDP. In the past, GDP growth in Malaysia is supported by the influx of foreign direct investment which fuels the export-oriented industries. Domestic investment in terms of infrastructure and human capital development further enhance the influx of foreign direct investment into Malaysia.

Hence, the main objective of this study is to derived a model which illustrates the dynamic interactions between income per capita, domestic investment and foreign investment. We extend the existing growth model by incorporating the impact of both domestic and foreign investment with a threshold which connotes the novelty of this study. Given the identification of the model, we estimate a threshold value which indicate the minimum or a threshold amount of investment needed to promote income per capita growth. Subsequently, we simulate the impact of shocks of foreign investment and domestic investment on income per capita. Finally, the robustness of the model (s) and the estimation of the threshold value (s) are conducted using heuristic approaches of genetic algorithm, neuro network and support vector machine.

The final outcome of this study is the formation of a generic theoretical model which is applicable, at least, in developing countries. The estimated threshold value (s) would be a guide to the government or policy makers as to how much investment is needed to sustain and increase income per capita. Eventually, the theoretical model serves as a benchmark model which would be useful for future simulations, predictions and other extensions in growth modelling in developing world.

5.2 Enhanced Executive Summary

(Abstract of the research) – 1 page only

Economists unanimously agree that foreign direct investment (FDI) somehow brought about economic growth and development. In this paper, we re-examine this popular view by estimating an optimal threshold value needed to promote growth. Results show that FDI enhances growth only if it is more than 3.14 percentage of GDP. Hence, policy enablers should ensure an annual increase of FDI influx of more 3.14 percent of GDP to ensure positive and sustainable growth.

5.3 Introduction

1 to 2 pages only

Following two major economic downturns in 1997-99 and 2008-2009, Malaysia has recorded mediocre growth of less than the pre-1997 crisis. Major weaknesses highlighted were lack of private investment, low-skilled labour, lack of innovation, administrative bureaucracy and numerous red-tapes. As a result, Malaysia remains a major exporter of low technology and low value added products. Apart from that, Malaysia is currently trapped in the middle income cohort as opposed to South Korea or Singapore which were on approximate grounds in the 1960s.

This paper extends previous literature on the FDI-economic growth nexus by estimating an optimal threshold value of FDI needed to enhance economic growth in Malaysia. Our critical innovation in the literature lies on the estimation of an optimal value for FDI needed to promote growth instead of merely estimating the impact of FDI on economic growth. Results should assist policy makers in targeting a certain minimum amount of FDI into the country annually anchored by a set of attractive strategic incentives.

5.4 Brief Literature Review

1 to 3 pages only

Economist have to a certain degree unanimously that FDI is a growth enhancing factor for the host country. Mello (1999) and Borensztein et al. (1998) assert that such critical notion is only holds in the presence of certain complimentary criteria such as the availability of human capital stock, sufficient absorption capacity and the interaction between complimentary and substitution effects of FDI and domestic investment.

With the exception of Choong et al. (2010), no known study has estimated a precise threshold for FDI needed to promote economic growth. Choong et al. (2010), estimated minimum amount of the stock traded in the market such that this would offset the negative impact of debts.